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Analysis of Business Trends Plus Selected Financial Indicators

Gulf Crisis Unnerves Currency Markets

The Gulf crisis has dominated movements in the foreign exchange markets ever since Iraq invaded Kuwait on August 2. This has resulted in wide currency swings as market sentiment toward various currencies has shifted on a dime, depending upon whether traders were focusing on the probability of a diplomatic or a military solution to the Mideast crisis, oil price gyrations, or the effects of higher oil prices on monetary policy and/or economic performance in a particular country.

Because of the dollar's traditional role as a "safe-haven" currency—which means investors would flock to the greenback in times of war because it is underpinned by the world's largest economy and its strongest military power—it jumped by three German pfennigs and four Japanese yen immediately after Iraq attacked Kuwait. It wasn't long, however, before traders began to focus on the effects of the crisis on the U.S. economy. Fears that the cost of the military buildup and higher oil prices would increase the probability of recession in the United States, place upward pressure on the inflation rate, and worsen the U.S. budget deficit, soon turned market sentiment sharply against the dollar. Negative sentiment was exacerbated by the widespread belief that the risk of recession would force the Federal Reserve to lower U.S. interest rates, reducing the appeal of the dollar even further. As a result, the dollar fell sharply against the yen and plunged to an all-time low of 1.5385 German marks on August 27.

However, as the military buildup in the Gulf intensified and hopes of a negotiated settlement dwindled, some of the dollar's safe-haven allure returned. At the same time, fears about the effects of higher oil prices on the U.S. inflation rate and the prospect of higher interest rates abroad have made the Fed extremely reluctant to lower interest rates. As a result, the dollar has been able to recoup some of its losses against the mark.

The Yen Rebounds

Although the dollar has recovered a bit against the mark this month, it has continued to decline against the yen, falling to a 13-month low of around 137 yen against the Japanese unit. After an initial selloff due to Japan's dependence on imported oil, the yen has been one of the best performing currencies since the Gulf crisis began. Rising interest rates are one reason. Fears that higher oil prices would add to inflation pressures prompted the Bank of Japan to lift its discount rate by 75 basis points to six percent on August 30, the highest level in eight years. As a result, Japanese short-term interest rates are now higher than U.S. rates.

Another reason for the yen's rebound has been a reversal of the huge capital outflows from Japan to the United States that had occurred in the 1980s. Reversing their investment strategy of the past decade, Japanese institutional investors are bringing their money home this year. They sold $8.9 billion of U.S. stocks and bonds during the first half of 1990, representing the first sustained net selling of U.S. securities since 1982. This change in investment strategy reflects investors' attempts to cover serious losses suffered in the Tokyo stock market plunge, the growing attraction of continental European securities and the diminishing appeal of the U.S. bond market as the differential between U.S. and Japanese bond yields has shrunk to less than 50 basis points.

Favorable interest rate differentials and positive economic fundamentals will probably cause the yen to continue to strengthen against the dollar and the European currencies as well. The yen has appreciated by over nine percent against the mark since mid-August as the higher-than-expected costs of German unification have turned market sentiment against the mark.

"High-Yielders" Lose Some Glitter

The Gulf crisis has made the always-volatile "high-yielding" currencies even more jittery than usual. For one thing, the return of volatility to the major markets has reduced traders' need for high interest income (Financial Digest—July 30). For another, the fact that many of the countries with high yields are also net energy exporters—namely, the United Kingdom, Canada and Australia—has added to trader un-

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certainty about whether to buy or sell their currencies in light of their otherwise weak economic fundamentals.

After the combination of lofty interest rates, the United Kingdom's status as a net oil exporter and the market's belief that the British government would enter sterling into the exchange rate mechanism (ERM) of the European Monetary System (EMS) in the near future propelled the pound to a nine-year high of $1.96 against the dollar, the currency plunged by over ten cents in a matter of two weeks as Chancellor of the Exchequer John Major dashed market hopes of an early entry of sterling into the ERM. With the outlook for oil prices, and consequently, the U.K. inflation rate now uncertain, Chancellor Major stated that he will use his judgement as to when his inflation prerequisites have been met, possibly delaying sterling's entry into the ERM until next year. This remark sparked the biggest one-day plunge in the pound in almost a year.

The Canadian dollar soared to a twelve-year high of almost US$0.89 against its U.S. counterpart last month until news that the Canadian economy contracted in the second quarter and the announcement that the Bank of Montreal cut its prime rate for the second time in a

Short Term Paper Outstanding

(Millions of Dollars)

Time Deposits $100,000 or more Weekly Reporting Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (9/5/90)	211,172	- 1,107	- 7,894
New York City (9/12/90)	37,586	+ 42	- 4,922
Commercial Paper (9/12/90)	549,939	+ 4,768	+ 36,477

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (9/5/90)	317,637	+ 178	- 509
New York City (9/12/90)	57,853	- 350	- 414

Total Loans and Leases Gross Adjust

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (9/5/90)	1,024,560	+ 7,536	+ 44,135
New York City (9/12/90)	182,530	- 4,511	+ 3,313

Financial Markets

	Friday 9/21/90	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	7.58%	+ .01	- .42
180-Day Bills†	7.73	+ .10	- .42
Longest Bills†	7.75	+ .05	- .46
Recent Issues:			
8¼s 8/31/92	8.10	+ .08	
8¼s 6/30/94	8.45	+ .07	
8¾s 8/15/00	8.98	+ .13	
8¾s 8/15/20	9.12	+ .12	
Municipals:			
Bond Buyer—20 Bond Index* (9/20/90)	7.41%	+ .06	+ .08
Blue List Total ($ Million)	$1,212	+ $264	- $ 363
30-Day Visible Supply ($ Million)	$1,717	+ $ 90	- $3,158
Total	$2,929	+ $354	- $3,521
Corporates:			
Moody's Aa Composite (9/20/90)	9.75	+ .04	+ .54
30-Day Visible Supply ($ Million)	$1,212	+ $200	- $4,827
Stocks:			
Dow-Jones Averages:			
Industrials	2,512.38	- 51.73	- 169.23
Transportation	876.30	- 13.12	- 571.96
Utilities	201.71	+ 2.51	- 15.03
65 Stocks	881.68	- 11.59	- 191.32
N.Y.S.E. Composite Index	171.03	- 3.12	- 21.70
N.Y.S.E. Avg. Daily Vol. for Week (000's)	149,390	+ 25,470	+10,296

*34% Taxable equivalent 11.23%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 9/21/90	Week Ago
Overnight	8.06%	7.94%
1 month	8.25	8.06
3 month	8.19	8.00
6 month	8.25	8.00
1 year	8.31	8.13

FOREIGN EXCHANGE SPOT RATES

New York Opening (9/21/90)	Currency Per U.S. $	Week Ago
Belgium	32.37	32.30
Canada	1.1556	1.1662
France	5.2740	5.2600
Germany	1.5750	1.5710
Italy	1174.00	1171.50
Japan	136.70	137.10
Mexico	2889.00	2884.20
Netherlands	1.7758	1.7705
South Korea	707.06	707.85
Switzerland	1.3200	1.3055
Taiwan	26.87	26.90
U.K.*	1.8485	1.8330

*U.S. $ per U.K. pound

MH TRADE-WEIGHTED DOLLAR (9/21/90) (Adjusted for Inflation)	Change Since Week Ago	Change Since 2/27/85
	+1.8%	-6.1%

month caused the currency to give back all of the gains that it made since the Gulf crisis began. Although Canada is a net energy exporter, the jump in oil prices couldn't have come at a worse time for the economy, already on the brink of recession due to the Bank of Canada's tight monetary policy.

The market's disenchantment with the high-yielding currencies also spread to the EMS. Just two months ago, the central banks of Spain and Italy were forced to intervene in the foreign exchange markets in order to keep the high-flying peseta and the lira within their permitted trading bands. However, because Spain and Italy are more vulnerable to rising oil prices than the other EMS countries—their inflation rates are higher and they have done less to reduce their dependence on oil—these currencies have lost much of their glitter, often requiring central bank intervention to prevent them from falling too fast.

While forecasting foreign exchange rates has never been easy, the Gulf crisis has made the task even more difficult. As long as the tensions in the Middle East remain, huge currency swings will likely continue as market participants try to decide what each piece of news means for a country's interest rate outlook and economic performance. ■

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 9/19/90	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	244.855	- .103	+18.631
Loans to Depository Inst.	.979	+ .547	+ .231
Float	.402	- 1.086	- .606
Total Reserve Bank Credit	287.095	- .344	+25.146
Treasury Deposits with Federal Reserve Banks	7.570	+ 2.880	+ 1.084
Currency in Circulation	272.957	- 1.144	+24.149
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	234.483	- 3.082	- 4.841
	9/19/90		
Member Bank Reserves:			
Total Reserves Held	60.672	+ 2.038	+ .776
Excess (Deficiency)	.733	- .176	- .155
Net Free Reserves	.033	- .246	- .262
		‡ % Change Since	
Monetary Aggregates †		**3 Months Ago***	**Year Ago**
M1 (9/10/90)	820.5	+ 5.9	+ 4.8
M2 (9/10/90)	3,317.6	+ 5.9	+ 5.0
M3 (9/10/90)	4,097.7	+ 4.0	+ 2.1
Domestic Nonfinancial Debt (1st Q'90)	9,987.4	+ 7.6	+ 8.1

† Seasonally adjusted. * Seasonally adjusted annual rate. ‡ Four-week moving average.

New York Money Market

Offering Rates 9/21/90	3 Months	6 Months	1 Year
‡ U.S. Treasury Bills	7.34%	7.30%	7.18%
* Federal Agencies	7.90	7.85	7.90
* Municipal Notes–High Grade (34% Taxable Equivalent)	8.71	8.93	9.09
Negotiable Time CDs			
Manufacturers Hanover	Rates By Arrangement		
* Secondary Market–Prime	8.25	8.25	8.20

‡ Finance Company Paper–Prime

5- 14 days	7.91%
15- 29 days	8.00
30- 59 days	7.90
60- 89 days	7.80
90-179 days	7.68
180-239 days	7.60
240-270 days	7.60

‡* Bankers' Acceptances

Oct.	8.17%
Nov.	8.05
Dec.	8.00
Jan.	7.98
Feb.	7.93
Mar.	7.90

‡ Industrial Paper–Prime

30- 89 days	7.98%
90-120 days	7.90

†Federal Funds Effective Rate 8.13%

‡ Discount basis. *Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	2nd Q'90	$ 5,452	$ 5,375	$ 5,174
Gross National Product (1982 Dollars)*	2nd Q'90	$ 4,163	$ 4,151	$ 4,112
Percent Change, Annual Rate	2nd Q'90	1.2	1.7	1.6
Change in Consumer Prices*	Aug '90n	9.6 %	4.8%	0.0%
Change in MH Cost of Living Index*	Aug '90n	4.8 %	6.0%	2.4%
Change in Producer Prices*	Aug '90n	15.6 %	- 1.2%	- 3.6%
Civilian Employment (Thousands of Persons) †	Aug '90	117,658	117,953	117,550
Unemployment as % of Civilian Labor Force †	Aug '90	5.6%	5.5%	5.3%
Personal Income*	Jul '90	$ 4,672	$ 4,646	$ 4,398
Leading Indicators Composite Index (1967=100) †	Jul '90	146.1	146.1	144.1
Industrial Production Index (1977=100) †	Aug '90n	109.8	110.0r	108.2
Net Change in Consumer Installment Credit †	Jul '90n	$ 4.47	$ 0.12r	$ 2.74
U.S. Merchandise Trade Balance †	Jul '90n	- $ 9.33	- $ 5.34r	- $ 9.08
Plant and Equipment Expenditures*	4th Q'90n	$ 538.6(a)	$ 532.5(a)r	$ 519.6r
Private Housing Starts (Thousands of Units)*	Aug '90n	1,127	1,147r	1,325
New Construction Expenditures*	Jul '90	$ 442.2	$ 440.4	$ 429.0
Total Business Inventories †	Jul '90n	$ 801.9	$ 796.5r	$ 788.6r
Total Business Sales †	Jul '90n	$ 539.5	$ 542.4r	$ 516.2

*Seasonally adjusted annual rate. † Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.

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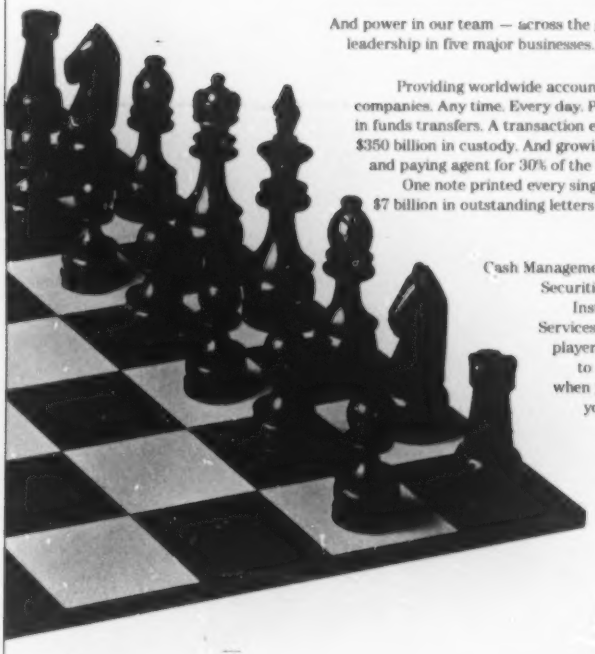
There's Strength In Our Numbers — Across The Board.



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